

Members:

Rep. Thomas Kromkowski, Chair
Rep. Dan Stevenson
Rep. Lawrence Buell
Rep. Richard Mangus
Sen. Joseph Harrison
Sen. Thomas Weatherwax
Sen. Joseph O'Day
Sen. Allie Craycraft



PENSION MANAGEMENT OVERSIGHT COMMISSION

**Legislative Services Agency
200 West Washington Street, Suite 301
Indianapolis, Indiana 46204-2789
Tel: (317) 232-9855 Fax: (317) 232-2554**

Lay Members:

Steve Meno
William Daniels
Connie Lux
William Gettings, Jr.

LSA Staff:

James Sperlik, Fiscal Analyst for the Commission
Edward Gohmann, Attorney for the Commission
Susan Montgomery, Attorney for the Commission

Authority: IC 2-5-12-1

MEETING MINUTES

Meeting Date: August 12, 1998
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington St.,
Room 404
Meeting City: Indianapolis, Indiana
Meeting Number: 1

Members Present: Rep. Thomas Kromkowski, Chairperson; Rep. Dan Stevenson;
Rep. Lawrence Buell; Rep. Richard Mangus; Sen. Thomas
Weatherwax; Sen. Joseph O'Day; Sen. Allie Craycraft; Steve
Meno; William Gettings, Jr.

Members Absent: Sen. Joseph Harrison; William Daniels; Connie Lux.

1. Call to Order; Introduction

Representative Tom Kromkowski, Chairman of the Commission, called the Commission to order at 10:15 a.m. After the members of the Commission introduced themselves, Representative Kromkowski commented that the Commission planned to study three topics that had been assigned to the Commission by the Legislative Council, plus certain other topics suggested by members of the Commission and by the state pension funds. He stated that the first meeting would be devoted to a brief introduction to a number of the study topics and that these topics would be studied in more detail at later meetings.

2. Conversion of PERF from a Defined Benefit Plan to a Defined Contribution Plan

Representative Kromkowski explained that the Legislative Council had requested the Commission to study the possibility of converting the Public Employees' Retirement Fund (PERF) from a defined benefit plan to a defined contribution plan. Representative Kromkowski then called on Mr. Doug Todd, an actuary with McCready and Keene, the firm that provides actuarial services to PERF.

Mr. Todd briefly described the differences between a defined benefit plan and a defined contribution plan, explaining that a defined benefit plan provides a benefit based on a formula (which usually takes into consideration compensation and years of service), while a defined contribution plan provides for the contribution -- by the employer or the employee, or both -- of a specific percentage of the employee's compensation. Mr. Todd noted that the pension portion of PERF benefits is an example of a defined benefit plan. He explained that the formula under which the pension portion of PERF benefits is determined provides for a benefit equal to 1.1% of the member's average annual compensation (calculated using the 20 calendar quarters in which the member's annual compensation was the highest) multiplied by the member's years of service. Mr. Todd then noted that the Legislators' Retirement System plan for legislators first elected after 1989 is an example of a defined contribution plan. Under that plan, participants make contributions equal to 5% of their salary and the state makes contributions equal to 20% of their salary.

Mr. Todd next explained that under a defined benefit plan, in which a member's benefit is not dependent on how plan investments perform, the plan sponsor -- and not the plan members -- bears the investment risk. He noted that under a defined contribution plan, the opposite is true: because a member's benefit is dependent on how the member's investments perform, the members bear the investment risk.

Mr. Todd stated that defined benefit plans generally favor members with longer service, while defined contribution plans generally favor members with shorter service. He then described several charts he had prepared for Commission members to help compare the value of benefits provided by PERF with benefits that could be earned under a defined contribution plan.¹ He explained that the charts compared the value of the pension portion of PERF benefits (i.e., excluding the value of the employee annuity account) with a defined contribution plan that required a contribution of 6% of a member's salary. He also noted that the comparisons assumed a 7.75% investment return and 5% annual salary increases. Mr. Todd stated that under each of the scenarios he had chosen (members beginning service at ages 25, 35, 40, 45, and 55) the value of the benefits under the defined contribution plan was initially larger, but grew at a slower rate than the value of the benefits under the defined benefit plan.

Senator Tom Weatherwax pointed out that the effects of the "Rule of 85", which allows members to retire with full benefits at age 55 if their years of service and age add up to

¹Copies of material presented by Mr. Todd to the Commission ("Comparison of PERF with 6% Defined Contribution Plan") are on file in the Legislative Information Center, Room 230, State House, Indianapolis, Indiana 46204. The telephone number of the Legislative Information Center is (317) 232-9856, and the mailing address is 200 W. Washington St., Suite 301, Indianapolis, Indiana 46204-2789.

85, could clearly be seen on the charts prepared by Mr. Todd. Mr. William Gettings commented that provisions similar to the "Rule of 85" are not common in private sector defined benefit plans.

Representative Larry Buell noted that Mr. Todd in making his comparisons had assumed an annual 5% salary growth, and he asked Mr. Todd what would be the effect if the salary growth were in fact lower. Mr. Todd explained that the assumptions used in the comparisons were the ones used in preparing actuarial valuations for PERF, and he stated that if there were lower salary growth it would cause the value of the benefits under the defined benefit plan to fall relative to the benefits under the defined compensation plan. He said that this result would occur because one of the strengths of defined benefit plans is that they typically use a final salary or an average of the last few salaries to determine the benefit. He reasoned that if there were lower growth this "boost" to a member's pension benefit would be absent.

Representative Kromkowski then called on Ms. Mary Beth Braitman, an attorney with Ice, Miller, Donadio, and Ryan, the law firm that provides legal services to PERF. Ms. Braitman noted that the value of the defined benefits in the charts prepared by Mr. Todd excluded the annuity savings account portion of PERF benefits. She explained that this portion of the current PERF benefit structure is similar to a defined contribution, and she stated that PERF in effect has a hybrid system containing both a defined benefit component and a component -- the annuity savings account -- that is similar to a defined contribution plan.

Ms. Braitman noted that many public employers that are studying the possibility of converting from a defined benefit plan to a defined contribution plan have been very interested in the structure used with PERF, because PERF's defined benefit component provides members with a stable, guaranteed benefit while the annuity savings account also allows members to direct their investments and gives them the ability to benefit from increases in the stock market. Ms. Braitman commented that one possible option to consider was allowing an employer match of some portion of a member's contribution to the deferred compensation plan. She stated that Oklahoma matches up to 25% of employee contributions to its deferred compensation plan.

Mr. Steve Meno asked whether, under a defined contribution plan, the 6% contribution would be the State's cost. Mr. Todd said that the cost would remain at 6% for the state. Mr. Gettings asked whether investments under a defined contribution plan would be directed by members. Mr. Gettings also noted that PERF members cannot elect a lump sum equivalent distribution of their defined benefit. He commented that in the private sector, many lump-sum pension distributions are not put into an annuity, and he also suggested that while an astute investor might be better off with access to a lump-sum distribution, for the average person the monthly guaranteed check from PERF might be better.

3. Self-insurance by the Indiana State Police

Representative Kromkowski stated that the Legislative Council had also requested the

Commission to study the issues concerning the establishment of common and unified plans for self-insurance by the Indiana State Police. He then called on Mr. Steve Buschmann, representing the Indiana State Police Alliance, for a brief introduction to this study topic.

Mr. Buschmann began by noting that State Police officers have a mandatory retirement age of age 60, and he explained that many of the officers in the pre-1987 retirement system are not covered by Medicare. He stated that this has led to retirees spending a large portion of their retirement benefits to pay for health insurance. Mr. Buschmann stated that in the 1998 session of the General Assembly, Senator Sue Landske had introduced Senate Bill 270, which allowed the Indiana State Police to provide a group insurance plan for retired officers in which those officers pay a negotiated premium and in which the cost of claims and administration would be recovered through increased premiums to active officers. Mr. Buschmann commented that when the bill was heard before the Senate Pensions and Labor Committee, there was some concern that its provisions were not specific enough. He noted that the Committee had tabled the bill and agreed to request that it be studied further during the interim. Mr. Buschmann stated that a study of the issue was being prepared for the Commission and that the Indiana State Police Alliance hoped to present the study and a specific proposal at a later meeting of the Commission.

4. PERF and TRF Proposals

Representative Kromkowski then said that the Commission would also review various proposals made by PERF and by the Teachers' Retirement Fund (TRF).² He then called on Mr. Mark Webb, the Director of PERF to describe briefly the proposals that PERF planned to bring before the Commission.

Mr. Webb stated that one proposed change that PERF and TRF are considering is to allow retirees to change beneficiaries in certain circumstances. He explained that under the current law, once a retiree's benefit is calculated, the retiree cannot change beneficiaries, because the benefit is based in part on the projected life-span of the beneficiary. Mr. Webb said that the public pension funds were considering the possibility of allowing retirees to change their beneficiaries in three circumstances: (1) after the death of the beneficiary; (2) if the retiree becomes divorced from the beneficiary; or (3) if the retiree marries. Mr. Webb noted that if retirees are allowed to change their beneficiaries under these circumstances, the law will have to allow for a recomputation of benefits.

Ms. Braitman stated that PERF and TRF are also exploring the feasibility of paying estimated benefits. She explained that the funds currently do not start paying benefits until all compensation and service records are finalized and that this can result in delays in the beginning of benefit payments. Ms. Braitman said that the funds could be

²Copies of the PERF and TRF proposals ("Legislation for Presentation to Pension Management Oversight Commission") are on file in the Legislative Information Center, Room 230, State House, Indianapolis, Indiana 46204. See footnote 1.

authorized to pay estimated benefits and to reconcile those payments with the final benefit once it is calculated.

Senator Weatherwax asked Ms. Braitman whether the funds could calculate an estimated benefit that closely matches the final benefit. She answered that usually they could make a very accurate estimate, but that it would be more difficult in the case of a member who has small amounts of service credit with many different employers.

Ms. Braitman stated that another proposal from the pension funds was to allow members to bifurcate the pension portion of their benefit from the annuity savings portion for purposes of the time at which those benefits begin. She explained that a member would be given the option of electing: (1) to receive their annuity savings account benefit (currently allowed in a full or partial lump sum or in annuitization of the account balance) at the same time their pension benefits begin; or (2) to begin receiving their pension benefit, but leave their annuity savings account invested until a later date, subject to federal Internal Revenue Service distribution requirements. Ms. Braitman explained that even if Indiana law were changed to provide members with the option to delay the distribution or annuitization of their annuity savings account balances, under Internal Revenue Service regulations the members would be forced to begin receiving benefits when they reached 70 ½ years of age. According to Ms. Braitman, the option would give members of PERF and TRF additional flexibility in retirement planning. Senator Craycraft pointed out that such flexibility might help those members who would like to plan how they will integrate their PERF or TRF retirement benefits with federal Social Security benefits or deferred compensation distributions.

Senator Weatherwax asked about the taxability of members' annuity savings account distributions. She replied that they were generally taxable, but that most members did have a tax basis -- a nontaxable portion -- in their account balances, because these amounts had been deposited before the State began to "pick-up" the members' contributions. She explained that as these people retired, there would eventually be no members with any tax basis in their accounts, and therefore the full amount would be taxable.

Ms. Braitman then said that the pension funds would like the authority to "cash out" small accounts with a total lifetime benefit of less than \$200 if there has been no activity on the account within two years. Mr. Gettings asked what dollar limits are usually included in private pension plans and whether PERF and TRF should use those amounts. Ms. Braitman answered that some private plans include "cash out" provisions for accounts of up to \$2,500, but that PERF or TRF wanted to avoid forcing out too many people. She also explained that with the \$200 limit PERF and TRF would be exempt from certain Internal Revenue Service notice and withholding requirements.

Ms. Braitman next explained that PERF and TRF both limit how much a person may earn in a covered position while receiving benefits. She noted that if a person earns more than that limit the person's benefits are suspended and the person is reinstated into active membership in PERF or TRF. According to Ms. Braitman, this limit is

currently tied to an index calculated under federal Social Security laws, and the index is scheduled to rise rapidly over the next few years. She stated that PERF and TRF were suggesting that the limit on earnings in covered positions be changed so that it would be a fixed amount, adjusted for inflation, and would not be tied to the federal index.

Ms. Braitman said that TRF was also proposing that its leave statutes be amended to allow for up to one year of adoption leave. She explained this would put members who adopt children in the same place as members who take maternity leave.

Representative Stevenson asked whether male TRF members would be eligible for the proposed adoption leave, and Ms. Braitman answered that they would be. Ms.

Braitman then stated that TRF was also proposing a change to the recently enacted statute allowing for the purchase of private school service credit by TRF members.

According to Ms. Braitman, the change would make the private school service credit provision consistent with other service credit provisions by allowing the purchase of private school service credit to be made after one year, while still providing that the member could not receive a benefit based on those purchased years of service until the member had ten years of in-state service.

Dr. Mary Pettersen, the Director of TRF, commented that there had been a great deal of interest in the purchase of private school service credit by TRF members, but under the current statute the members cannot purchase the private school service credit until after completing ten years in a TRF-covered position. Representative Stevenson, who had authored the bill allowing the purchase of private school service credit, observed that the intent of the bill had been to allow the purchase of the credit after one year, while prohibiting the purchased credit from being used until the member had ten years of service in a TRF-covered position.

Ms. Braitman then explained that PERF is proposing the adoption of an enforcement mechanism that could be used if an employer does not timely provide contributions and membership records. She said that under the new system of allowing members to direct the investment of their annuity savings accounts it is vital to receive the contributions and information on time. She stated PERF usually receives the contributions on time, but that membership records are often delayed or not complete. She also explained that current law allows the Auditor of State to withhold funds payable to employers that have not provided PERF with required contributions or information. Ms. Braitman pointed out, however, that this enforcement mechanism is a drastic one that is seldom used. She said that PERF was proposing an enforcement mechanism similar to that adopted for TRF, where, after a grace period of 30 days, employers who do not provide required contributions or information would be fined \$100 for each day the contribution or information is late.

According to Ms. Braitman, PERF believes that a time limit of 90 days should be enacted for disability hearings held by local boards under the 1977 Fund law. She noted that under the current law there is no time period within which a hearing must be held. Ms. Braitman also stated that PERF was proposing a requirement that a local board must make its determination within 30 days after holding a disability hearing. Mr. Bill Gettings briefly questioned Ms. Braitman on the different types of disability benefits

paid by the 1977 Fund. Senator Craycraft questioned the way in which deaths in the line of duty are differentiated from deaths that are not in the line of duty. He described a situation in which a Muncie firefighter had, after fighting a fire, returned to the firehouse and died of a heart attack while sleeping. Senator Craycraft said that he thought this firefighter, who died while working his shift, should be considered to have died in the line of duty.

Ms. Braitman then described PERF's recent problems with erroneously enrolled members. She explained that current law prohibits persons who are working in a position covered by another plan to be a member of PERF even if the person was working in a second, PERF-covered position. She stated that there had been a small number of cases where such persons had erroneously been made members of PERF. According to Ms. Braitman, in these cases the problems surfaced when the erroneously enrolled members were denied PERF benefits. Ms. Braitman suggested that there were two approaches the Commission could take in addressing this issue: the Commission could recommend a solution directed only toward the specific individuals known to PERF, or it could take a more general and comprehensive approach to all persons who may be working in two full-time positions at the same time.

She stated that PERF and TRF also had drafted proposals concerning the valuation of members' annuity savings accounts. According to Ms. Braitman, the valuation of a member's annuity saving account for pay-out purposes is currently being done quarterly, but PERF and TRF believe that with the new record keeping requirements instituted under member-directed investment, the valuation could be done monthly.

Ms. Braitman also stated that PERF was proposing that when a unit converts to 1977 Fund coverage, the 1977 Fund's age restrictions would not apply to employees of the converting units. She also noted that PERF was proposing to allow judges in the Judges' Retirement System to purchase, at full cost to the judges, service credit for prior service in PERF-covered positions. She explained that the current statutes allow the purchase of service credit only for limited types of prior service, such as PERF-covered service as a commissioner, magistrate, or referee.

Representative Kromkowski commented that the last proposal from TRF concerned credit for military service. He noted that though the issue has been discussed for a number of years, no consensus has emerged because there is a lack of information available for the General Assembly to use in calculating the cost of various military service credit proposals. Representative Kromkowski said that there was, for example, little data available to determine how many retired and active TRF members had entered military service before beginning teacher training.

Representative Kromkowski requested Dr. Pettersen to work with Mr. Steve Moberly of the Indiana Retired Teachers' Association to compile the data necessary to make decisions on military service credit legislation. Mr. Moberly said that a disclaimer of some type could be added to any surveys conducted, and he added that this would prevent TRF members from incorrectly assuming that merely because there was a

survey concerning military service they would receive additional service credit for that military service. Dr. Pettersen stated that she would work with the Indiana Retired Teachers' Association and with the Commission, but that her staff was limited and was occupied with the issues concerning investments in equities and member-directed investment of annuity savings accounts.

5. Other Study Topics Suggested by Commission Members

Representative Kromkowski asked the members of the Commission if they had any other suggested topics for study during the interim.

A. Emergency Medical Service Employees; Correctional Officers

Senator Craycraft asked Representative Kromkowski if Mr. Hudson of the Delaware County Emergency Medical Service could address the Commission concerning a pension issue. Mr. Hudson explained that many emergency medical service employees leave their jobs and join police and fire departments, in part because of the better pension benefits available under the 1977 Fund. He suggested that counties be given the option of establishing separate pension funds for emergency medical service employees. He stated that these funds would be similar to the funds established for officers in a county sheriff's department.

Senator Weatherwax commented that a separate fund would still have to be actuarially funded by the county and that there would be an expense in moving emergency medical service employees from PERF to a separate fund. Ms. Braitman noted that one possibility was to allow county emergency medical service employees to become members of the 1977 Fund. Representative Dan Stevenson suggested that a similar issue was whether correctional officers should be members of the 1977 Fund. Representative Stevenson stated that they are law enforcement officers and are similar in many ways to the police officers who are members of the police and firefighter retirement systems.

B. Cost-of-Living Adjustments

Representative Buell commented that the legislation for PERF and TRF cost-of-living adjustments or for supplemental "thirteenth checks" often is introduced without being studied by the Commission. He suggested that the Commission should consider making an annual recommendation on the need for and amount of cost-of-living adjustments. Senator Craycraft agreed and he stated that he had always supported enacting some form of automatic cost-of-living adjustment. Senator Weatherwax stated that the Commission would have to consider the costs associated with such an automatic cost-of-living adjustment.

C. Unfunded Pension Liabilities

Senator Weatherwax suggested that the Commission should study the possibility of recommending that the General Assembly use a portion of the state budget surplus to

address the unfunded pension liabilities of TRF and local police and firefighter pension funds. Senator Craycraft commented that the Commission had in the past recommended such a use of state money. Ms. Braitman noted that during the past session the General Assembly had taken actions that would help cities and towns meet their pension obligations for public safety officers, but that municipalities still face difficult pension obligations.

6. TRF Investment in Equities

Representative Buell and Senator Weatherwax stated that they would like TRF to address the Commission concerning the fund's progress in investing in equities. Ms. Braitman explained that both PERF and TRF had moved forward in their plans to invest in equities. She stated that both funds had completed liability studies, asset allocation studies, and reviews of cash flow obligations. She also noted that TRF had a much greater proportionate share of its assets in members' annuity savings accounts and that this money could not be invested in equities until the plans for members' direction of their investments had been finalized. Ms. Braitman also explained that any investment in equities had to be made in a structured, periodic manner that was designed to reach the established asset allocation targets. She stated that now that the groundwork had been completed, TRF was moving forward.

Senator Weatherwax stated that some explanation was necessary because of the large amounts of money involved. Ms. Braitman said she would prepare a time line to demonstrate the actions PERF and TRF had taken concerning investment in equities.

Representative Buell said that he appreciated both the differences between PERF and TRF and the difficulties involved, but that there appeared to be problems with TRF's performance in investing in equities. He noted that one year ago the Commission had heard a report from TRF outlining a proposed time line, and he said that the Commission had agreed that a cautious approach to investing in equities was best. Representative Buell stated that the Commission needed answers concerning why it had taken another year for TRF to begin investing in equities. He said that the members of the General Assembly had fought for years to amend the Indiana Constitution to allow such investments, primarily to help TRF, and that he was extremely concerned at the response from TRF. He asked that Dr. Pettersen address the Commission concerning TRF's investment in equities.

Representative Kromkowski thanked the Commission members for their work, and he noted that the date of the next Commission meeting had not yet been determined. He then adjourned the meeting at 12:30 p.m.